We are pleased to release the results of our first annual Canadian Insurance Industry Risks and Opportunities Survey. This survey was launched at our 22nd Annual Insurance Issues Conference on December 2, 2013, and included further responses from industry participants in the weeks following the conference. Our purpose for this survey is to portray a Canadian perspective on both the risks and the opportunities insurers face in the current environment. The results reflect the views of 172 industry participants, of which 58 percent are within the Property and Casualty (P&C) insurance industry and 42 percent in the Life insurance industry.

### The Top 10 Risks

<table>
<thead>
<tr>
<th>Life Insurance Companies</th>
<th>P&amp;C Insurance Companies</th>
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<tbody>
<tr>
<td><strong>01</strong> Regulatory and compliance burden 86%</td>
<td>Regulatory and compliance burden 67%</td>
</tr>
<tr>
<td><strong>02</strong> Accounting and actuarial change 76%</td>
<td>Catastrophic loss events 63%</td>
</tr>
<tr>
<td><strong>03</strong> Low interest rates 74%</td>
<td>Low interest rates 60%</td>
</tr>
<tr>
<td><strong>04</strong> Increased regulatory capital requirements 61%</td>
<td>Accounting and actuarial changes 52%</td>
</tr>
<tr>
<td><strong>05</strong> Cost reduction pressures increasing operational risk exposures 43%</td>
<td>Climate changes affecting claims costs 47%</td>
</tr>
<tr>
<td><strong>06</strong> Demographic changes 36%</td>
<td>Cost and risks of IT investments 45%</td>
</tr>
<tr>
<td><strong>07</strong> Cybersecurity risks 36%</td>
<td>Consumer preferences that shift to newer distribution channels 42%</td>
</tr>
<tr>
<td><strong>08</strong> Cost and risks of IT investments 33%</td>
<td>Regulation of insurance pricing 39%</td>
</tr>
<tr>
<td><strong>09</strong> Consumer preferences that shift to newer distribution channels 33%</td>
<td>Competitors with better data analytic capability 36%</td>
</tr>
<tr>
<td><strong>10</strong> Competition with better customer technology 31%</td>
<td>Consolidation resulting in dominant competitors 34%</td>
</tr>
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### 2013 – A Year of Catastrophes for General Insurers!

2013 proved to be a year of diverging fortunes for the Canadian insurance industry, depending on whether you were a Life or P&C insurer. Life insurers were “basking” in the tentative stirrings of economic recovery in North America, reflected in increasing interest rates and strong improvement in the stock markets in Canada, the USA and globally. On the other hand, as we gathered together in December, for many P&C insurers the sunnier financial markets were overwhelmed by the gloomy picture of Ontario automobile insurance pricing pressures and the most expensive year ever for natural disasters in Canada. Who knew that less than three weeks later yet another catastrophic event would be inflicted on the P&C insurance industry in the shape of the ice storm in Eastern Canada.

With this backdrop we asked people to identify the risks and opportunities that they saw for the Canadian Life and P&C insurance industries.
Canadian Insurance Industry Risks & Opportunities Survey – May 2014

Risks

Consistency Across the Board
Surprisingly, or perhaps not so, within the top three risks there was remarkable consistency in the responses between the P&C and Life participants, particularly if you think of accounting and actuarial change as a catastrophic event, which it appears some in the life industry do.

It’s clear that the Life industry is facing the very significant changes associated with IFRS 4 with a high degree of trepidation and concern. The implementation of IFRS 4 will necessitate wholesale changes to financial systems, processes, financial statements and methods of communicating financial results. With IFRS 4 now in a three year countdown to implementation, it is already clearly top of mind. On top of this, Canadian insurers are about to take a world leadership role with Own Risk & Solvency Assessment (ORSA), taking centre stage with a 2014 implementation timeline.

While interest rates may have ticked upward somewhat in the past 12-18 months, historically low interest rates continue to linger as an issue for both Life and P&C insurers, albeit for differing reasons. The Bank of Canada’s concerns regarding lower than expected inflation, leaving the door open for further interest rate cuts, do not do much to allay the concerns of insurers although certainly the Life insurers are currently enjoying the fruits of a bullish stock market.

The P&C Insurance Industry – More Risks, Where is the Reward?
The P&C insurance industry clearly has some specific industry challenges that are severely impacting its profitability. Ontario auto, a highly regulated product, has now become a political football and is facing a mandated 15 percent premium reduction with an understanding that reforms will drive similar cost savings. The mandated premium reduction is underway, but the cost savings have yet to be realized and therein lays the risk. With a review underway, the question is how to fix the auto insurance system in Ontario to the satisfaction of all stakeholders.

The catastrophic loss events that occurred in 2013 represent an expensive “education” for Canadian insurers. On a positive note, 2013 provided the industry with significant learnings as to the impact of water that can be applied going forward, and numerous government, industry and company specific initiatives are underway. Certainly the lessons learned from these “water” related losses are causing stakeholders to revisit earthquake scenarios. That all said, the question that remains unanswered (and possibly unknowable) is whether 2013 is the “new normal?” Just to confuse the issue, the US National Hurricane Center only reported two Hurricanes for the 2013 season, neither of which reached the US, after they had initially predicted a “busy season.”

Furthermore…
In the P&C insurance industry, the cost and risks of IT investments came in at #6 (45 percent) and in the Life industry it was #8 (33 percent). In an industry bedeviled with legacy systems it’s not surprising that this is a significant issue. The cost, complexity and time for legacy replacement mean significant risk and the question that needs answering is whether the investment in technology delivers quantifiable benefits.

Within the top three risks there was remarkable consistency between P&C and Life participants.

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cost benefit. KPMG research and analysis shows that a sample of 12 of the larger P&C insurers, in aggregate for the period 2007 through 2012, spent approximately $5bn to $6bn on IT (using 3.5 percent to 4 percent of Net Written Premium (NWP) as a proxy). Over the same period their combined expense ratio for this same group (commissions and general expenses but excluding taxes) declined from 26.4 percent to 26.1 percent of NWP. Despite very significant IT expenditures we have yet to see a decline in industry operating costs.

We were also surprised that cyber security did not seem to resonate as a risk as strongly as we thought it might. Insurance companies are built on the foundation of trust. In return for an upfront premium they sell a promise to provide financial compensation should something “bad” happen sometime in the future. In fulfilling their mandate of providing ongoing protection, insurance companies collect significant personal information on their policyholders (financial, health related, etc.). It is this data that is of interest to hackers. While it is entirely possible that a retail chain may recover from an instance of hacking, the bar is most certainly higher for an insurance company where the reputation of the seller of the future promise is so much more important.
## Opportunities

Moving on from the “realists” to the “optimists,” it was interesting to see some clear themes as to the opportunities that exist. But first…

**ORSA: An Opportunity, Who Knew!**

65 percent of Life participants identified “improved understanding of risk and capital (better use of capital and management of risk)” as their clear #2 opportunity and 64 percent of P&C insurance industry participants identified this as the industry’s joint top opportunity. We have spoken to industry participants at length about ORSA over the past 12 months and have now completed over a dozen ORSA related projects in the past eight months alone. Based on our experience it would be fair to say that we have seen the mood and the attitude change quite significantly as companies have gained an increased understanding of ORSA and its constituent components as they set sail on the ORSA journey. From talking and working with you we can say quite confidently that insurers are now beginning to see that ORSA will provide them with:

- A better understanding of the capital they actually require to operate their business which will drive more informed decisions; and
- A deeper understanding of their risks through the discussions that have ensued from the development of Risk Appetite Statements and the underlying Enterprise Risk Management (ERM) frameworks.

As a final observation, it is clear that ORSA is a journey. 2014 will be the year for developing the foundational building blocks. Integrating and embedding these building blocks into ongoing management processes will be 2015 and beyond.

**Customers, Process & Technology**

Both the Life and P&C participants were very similar in their identification of the top 5 opportunities:

On the Life side, cost reduction initiatives rounded out the top 5 and on the P&C side, telematics made it to #4 with 49 percent of people viewing it as an opportunity.

### Industry Alignment

**Consensus on top opportunities**

<table>
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<tr>
<th></th>
<th>% Selected/Ranking</th>
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<tbody>
<tr>
<td><strong>Life</strong></td>
<td></td>
</tr>
<tr>
<td>Improvement of operation processes and technology</td>
<td>68% 01</td>
</tr>
<tr>
<td>Customer data analytics</td>
<td>49% 03</td>
</tr>
<tr>
<td>Customer self service technology</td>
<td>40% 04</td>
</tr>
<tr>
<td><strong>P&amp;C</strong></td>
<td></td>
</tr>
<tr>
<td>Improvement of operation processes and technology</td>
<td>56% 03</td>
</tr>
<tr>
<td>Customer data analytics</td>
<td>64% 02</td>
</tr>
<tr>
<td>Customer self service technology</td>
<td>40% 05</td>
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</tbody>
</table>

As we noted previously, the insurance industry is the owner of many legacy systems. With legacy systems comes legacy processes. Combined, neither is particularly efficient, especially when compared to industries where 24/7 interaction with their customers has resulted in highly efficient solutions and processes. It is heartening to see that the survey participants feel the same way with the opportunity for improved processes and technology ranking #1 in Life and #3 in P&C. That said, the P&C insurance experience would suggest that despite very significant expenditures on IT the realization of benefits has yet to occur.
The Insurance Industry – Amazonian
We Are Not
In a world where Amazon is one of
the biggest consumer brands today,
where information is available via the
web 24/7, 365 days a year and people
can do their banking in their pajamas
at 3 am, insurers have their work
cut out for them when it comes to
customer expectations as to self-service
technology (excepting medical and
dental claims). Surprisingly, only
40 percent of our respondents believe
that customer self-service technology
represents a significant opportunity
for both P&C and Life insurers to both
improve service and reduce cost.
In today’s world, how are insurance
companies going to embrace technology
and develop business strategies that
recognize the new reality to give
customers the same experience that
they have become accustomed to
from their banks, travel providers and
retailers? Indeed, the use of technology
to enhance the customer experience is
only limited by one’s imagination (and
the availability of integrated technology
solutions).

Customer Analytics & Big Data
Customer analytics and big data were
identified as a significant opportunity
(#2 in P&C at 64 percent and #3 in
Life at 49 percent). For Life insurers,
after a couple of years of adopting
defensive strategies and focusing
internally on efficiency, we believe
that the sector now appears poised
for growth. A significant opportunity
exists and insurers who can be first to
market with innovative products and
services will gain market advantage. The
unprecedented shift in demographics is
driving changing customer needs and
expectations as to new ways of doing
business. Business and technology
programs focused on big data and digital
services will be key to future success in
the marketplace.

Our research has found that 76 percent
of companies surveyed in the Americas
considered data and analytics to be
truly crucial to their current growth plans.

Summary
The 2013 financial year end is over, ORSA implementation plans have, by now, been provided to
OSFI and the planning work for IFRS 4 is picking up. Regulatory and accounting pressures will
continue (if not increase) for the foreseeable future and the effort and cost associated with the
required remediation will have to be operationalized and assumed within operating budgets.

So, that all said, many of the risks identified within the survey are to some degree within your control,
maybe with the exception of interest rates and the weather. Let us hope for a year with little or no
volatility in either. Let us also hope that there is some budget left over for all of you to focus on the
opportunities that exist in the marketplace!

Thank you for participating in our inaugural Canadian Insurance Industry Risks and Opportunities
Survey. We trust that you found the results interesting and we look forward to the second edition.

Data Dilemma

85% said that one of the
biggest challenges is with
implementing the right
solutions to accurately
analyze and interpret data
that they already had.

More than half of all
respondents (54%) also
said that one of their
biggest barriers is an
inability to identify what
data to collect.

The full results of KPMG International’s
recent Data and Analytics survey can be
obtained from the link provided.

IssuesAndInsights/ArticlesPublications/
Documents/going-beyond-data-and-
analytics-v4.pdf

KPMG member firms believe in the power of big data. In November 2013, KPMG in the USA
launched KPMG Capital, a $100m investment fund to invest in big data and data analytics
companies. We believe!
Pressure

You are struggling with restrictive legacy systems and need to consider new technology.

You must improve product profitability and launch something new and better.

And you needed to do it yesterday without increasing costs or headcount.

You don’t need to handle the pressure alone. At KPMG we can help you set, support and sustain your business strategies. We can help relieve your Pressure.

Let’s start the conversation.

kpmg.ca/insurance  kpmg.ca/financialservices
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